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DALAL STREET INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION

UPSTREAM PICK

February 2019

THINK DIFFERENT PROFIT MORE

Company Name	:	**Escorts Limited**
BSE Code	:	**500495**
Time Duration	:	**2 year**
CMP	:	**₹684.10 (as on 07 Februay, 2019)**
Target Price	:	**₹925**

Our Upstream Pick for the month of February is Escorts Limited. The company is engaged in manufacturing of agriculture machinery, construction equipment and railway equipment. The company's revenue mix in Q3FY19 comprised of agri machinery (78%), construction equipment (16%) and railway equipment (6%). The company enjoys around 11.4% market share in the tractor industry.

Looking at the current market scenario, the automobile industry is going through a bumpy ride due to various reasons such as poor demand, crisis in the NBFC sector, higher crude oil prices etc. But we believe that Escorts has a well-oiled strategy and is poised to capture market share and continue its upward growth trajectory in the medium-term also. Thus, we have chosen Escorts as our Upstream pick for this month.

Tractor segment: Sowing the seeds of growth :

Under the tractor segment, as of Q3FY19, the company enjoys nearly 11.4% market share (gained 130 bps yoy) and targeting to further take it to 12% by end of FY19. On the geographical front, the volume mix as of FY18 was North (51%), East (16%), Central (16%), West (10%) and South (7%). The company aims to nurture the trees that are already bearing sweet fruits. Thus, it aims to further expand its presence across North and East market by focusing on expanding dealer network, which currently stands at 920. Also, the dealer inventory has come down to 3-3.5 weeks from 5 weeks, which would further improve the working capital going ahead, resulting in improvement in operating margins.

To further expand its export business, Escorts has entered into 40:60 JV with partnership with Kubota Corporation to manufacture high-end technology tractors for both domestic and export geographies with an initial investment of Rs 300 crore. The total initial capacity would be 50,000 tractors and will start manufacturing by FY20-21. The company is targeting to achieve 8,000-10,000 export volumes by FY22 (2064 units in 9MFY19).

It has also recently launched new tractor series of 70-90HP to further gain traction in >50HP tractor market in which the company holds nearly 6.3% market share.

On the industry front, in Q3FY19, the domestic tractor industry volume rose by 19% yoy. However, in Q4FY19, the growth is likely to be in-between 3-5% due to higher base. The industry is likely to pick up from Q1FY20.

Construction equipment to help build growth story

Over the last four years, Escorts has successfully managed to turnaround its construction equipment division with EBIT profit of Rs 15 crore as against EBIT loss of Rs 32.2. Going forward, with launch of niche products with application focus and improvement in product mix, the company aims to accelerate growth of this division. Also, to strengthen its market position, Escorts has entered into an exclusive distribution agreement with South Korea's Doosan Infracore in February 2018, which would help it to develop differentiated products for foreign geographies such as cranes and backhoes for focused markets.

Further, in August 2018, Escorts has also formed 49:51 joint venture partnership with Japan's Tadano group for manufacturing rough terrain cranes and truck cranes. This JV would further enhance Escort's presence in the material handling equipment segment.

The growth of the construction segment is mainly dependent on the growth of real estate construction and infrastructure activity in the country. The government is spending heavily on the improvement and expansion of infrastructure in the country. Also, with various schemes and the structural reform in real estate, construction activity in the country is likely to get some boost. Thus, the impetus from the government to the sector is likely to provide good opportunity for the company in the medium term.

Railway: healthy order book provides good revenue visibility

In railway division, the company manufactures and supplies brake systems, couplers, suspension systems and rubber and friction products. Under this segment, the company holds healthy order book of Rs. 450 crore as on December 31,2018, which would be

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executed in the next 13-15 months. This order book translates into book-to-bill of 1.6x on FY18 revenue of railway division, thus, giving good revenue visibility.

Capex Update

The company has planned capex of Rs 150 crore for FY19 and Rs 300 crore for FY20. The company has already utilised Rs 100 crore of capex for establishing machining centre. Also, the company is expecting GST refund of around Rs 130-140 crore, which would be utilised for further expansion.

Improving financial performance across the board

On a standalone basis, the company reported revenue of Rs. 1,655.06 crore in Q3FY19, registering a growth of 37.34%. This was supported by jump in revenues from agri machinery, construction equipment and railway by 36%, 44% and 34%, respectively on yoy basis. Also, the volumes from agri machinery and construction equipment grew by 34% and 30% yoy, respectively.

EBITDA surged 38.23% to Rs. 200.47 crore in Q3FY19 from Rs. 145.02 crore in Q3FY18. EBITDA margin for the quarter ended December 2018 stood at 12.1%. Consequently, net profit jumped to Rs. 140.11 crore, representing an increase of 52.32%. The PAT margin stood at 8.46%, thereby showcasing margin expansion of 83 bps.

Valuation & Outlook

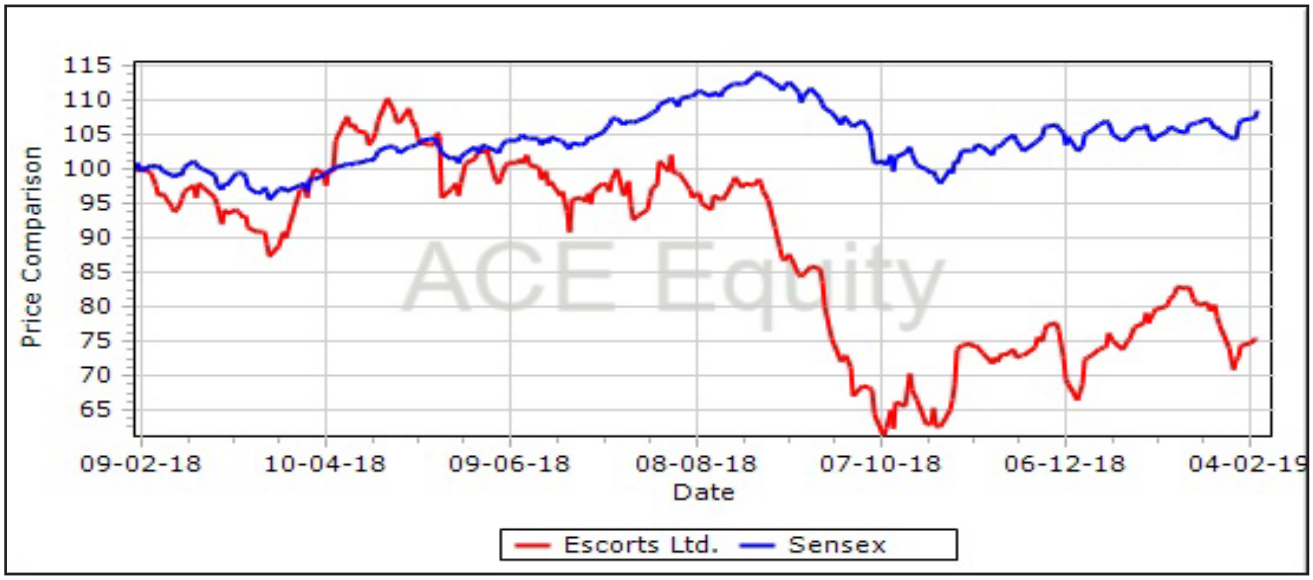
Moving forward, the company's aim to further strengthen its position in the northern region by expanding its footprint, coupled with strong order book of the railway division and good prospects for the construction division lend us the confidence to invest in this scrip. In terms of valuation, the stock of Escort is presently available at P/E multiple of 17.7x on TTM earnings, which looks attractive as compared with its five-year median P/E of 24x. Owing to all these factors, we urge our investors to **BUY** this stock. We see a potential upside of 35% with a target price of Rs 925 over a period of two years.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	4995.12	4147.07	3469.18	3985.83	6291.51
Total Income	5060.16	4221.35	3586.00	4050.57	6372.92
Total Expenditure	4443.53	3870.72	3379.39	3828.52	5910.27
PBIDT	616.63	350.63	206.61	222.05	462.65
PAT	344.72	160.44	83.75	74.71	244.89
Dividend %	20.00	15.00	12.00	12.00	18.00
Adj. EPS(Rs)	28.12	13.09	6.83	6.26	20.53

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201812	201809	Q on Q Var%	201712	Y on Y Var%
Net Sales	1655.06	1398.36	18.36	1205.03	37.35
Total Expenditure	1454.58	1240.87	17.22	1060.00	37.22
PBIDT (Excl OI)	200.48	157.49	27.30	145.03	38.24
PAT	140.11	102.65	36.50	91.98	52.33
PBIDTM% (Excl OI)	12.11	11.26	7.55	12.04	0.58
PBIDTM%	13.59	12.84	5.84	12.72	6.84
PATM%	8.47	7.34	15.40	7.63	11.01
Adj. EPS(Rs)	11.43	8.37	36.56	7.50	52.40



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